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DEPARTMENT OF AGRICULTURE
 OFFICE OF THE SECRETARY
 WASHINGTON, D. C. 20250

December 3, 1982

MEMORANDUM FOR MR. BURLEIGH LEONARD
 SENIOR STAFF MEMBER
 OFFICE OF POLICY DEVELOPMENT
 THE WHITE HOUSE

SUBJECT: Papers for Food and Agriculture Cabinet Council--U.S. Agricultural Trade Initiatives

NSC review completed.

Attached is a set of eight action proposals for consideration by participants in the SIG-IEP. These proposals reflect the recent GATT and OECD discussions and should be reviewed prior to the high-level bilateral discussion with the European Community December 10 in Brussels.

The European Community persists in tactics to avoid addressing the export subsidy question, and this is becoming politically intolerable. American agriculture is up in arms over such developments as the following:

- EC wheat exports have increased nearly 5 fold during the past decade, using heavy export subsidies. The EC is now the world's fourth largest wheat exporter.
- The EC has gone from a net importer of sugar in 1978 to the world's largest exporter - 5.0 million MT in 1981-82.
- The EC has moved from the world's largest importer of poultry in the mid-1970's to the world's largest exporter, with 35 percent of the world broiler market.
- The EC is now the world's largest egg exporter, shipping 67,000 tons. Prior to the inception of the egg CAP in 1967 the EC was the world's largest importer, importing 51,000 tons.
- The EC is the world's largest dairy exporter, accounting for about 60 percent of world trade, with subsidies set at \$1.9 billion in 1982.
- The EC is the world's second largest exporter of beef and veal, following behind only Australia. The EC has appropriated \$728 million for beef and veal export subsidies in 1982.
- Total EC agricultural export subsidy expenditures amounted to \$7.6 billion in 1980. Using the same exchange rate for conversion, total export subsidies appropriated by the EC reached \$8.0 billion in 1982.

Attached are eight proposals, designed to cope with these subsidies, for your consideration. Backup papers are available.

Summary of USDA Proposals

1. Direct sale of CCC Butter Stocks

The Commodity Credit Corporation owns 2.4 billion pounds of dairy stocks. The EC is the largest exporter of dairy products in the world with 40-50 percent of the world cheese market and 60 percent of the world butter market -- mostly based on export subsidies.

- Proposal A: Unrestricted competitive sale of 25,000 tons of butter.
- Proposal B: Unrestricted competitive sale of butter stocks up to the level of the entire CCC inventory.
- Proposal C: Sell through an intermediary country. Example: A major producing country has offered to buy 100,000 tons of CCC butter.
- Proposal D: Set up a barter arrangement. Example: A U.S. export firm is pressing for a barter of U.S. butter for Soviet nickel for the U.S. national strategic stockpile.

2. Flour Subsidy to Egypt

Egypt is the world's largest importer of wheat flour accounting for a third of the world market. The Egyptian market has almost doubled in the past three year and the EC, with export subsidies of \$80-\$100 per ton, captured all of that growth. The U.S. no longer has any share of the commercial market.

- Proposal A: Initiate a direct cash subsidy on flour exports.
- Proposal B: Initiate a payment-in-kind subsidy using surplus stocks of wheat.

3. Expanded Blended Credit Program

The U.S. has large stocks of basic commodities. The blended interest announced on October 20 began to move these stocks into export markets. Extension of this program will signal the EC that we can and will compete. Of the \$500 million first year blended credit authorization, \$440 million has been allocated.

- Proposal: Provide the additional \$500 million in direct credit authorized in the Agriculture Appropriation Bills.

4. Subsidize Exports of High Value Commodities

The U.S. accounts for only 10 percent of the global market for high-value food products, although it has a 40 percent share of the world's agricultural tonnage. The EC's high-value exports are double the U.S. level, based on export subsidies used to achieve high value export gains. The U.S. is slowly losing out in this important market.

- Proposal A: Initiate a selective export subsidy on high value products utilizing \$75 million remaining from the Helms amendment.
- Proposal B: Initiate a selective export subsidy utilizing surplus stocks of CCC commodities.

5. Increase PL 480 Funding

The level of PL 480 funding in FY 1983 is about \$1.5 billion. With additional funding of \$1 billion, the U.S. could likely export at least 5 million tons of additional grain, soybean/oil/meal, and cotton during the year.

Proposal: Expand PL 480 by an additional \$1 billion for FY 1983.

6. Donate CCC Stocks for Emergency Food Reserves

The U.S. is one of the few countries with a reserve stocks program. The U.S. would benefit if other countries developed reserve stock programs. Some shift in the stockholding patterns could be achieved if the U.S. donated grain to certain countries.

Proposal: Assist developing countries create an emergency food reserve using CCC donations from the United States.

7: Use Economic Support Funds to Generate Agricultural Exports

The International Affairs Budget includes Economic Support Funds used primarily for balance of payments support to politically important countries. Currently, only \$1.1 billion of the authorized \$2.8 billion is being used to purchase U.S. farm products. Recipient countries could be encouraged to increase their purchases from the United States, which would be very helpful to U.S. agricultural exports.

Proposal: Provide State Department encouragement to recipient countries to increase imports of U.S. agricultural commodities.

8. New LTA with the Soviets

The U.S. made available to the USSR up to 23 million tons of wheat/corn for purchase during the year ending September 30, 1983. The Soviets have bought less than 3 million tons to date. The USSR has asked that we meet to discuss a new LTA.

Proposal: Undertake to negotiate a new LTA with the USSR.

YUGOSLAVIA

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Yugoslavia

Recent Developments

In the November 29 SIG meeting it was agreed that we would meet with a small group of Europeans to review the Yugoslav financial situation and to seek their views on a financial package for Yugoslavia.

A special five-nation (U.S., UK, France, FRG and Italy) meeting was held on December 2, 1982. They agreed that 1) the West has significant geopolitical interests in maintaining the stability and orientation of the present Yugoslav Government; 2) that the political fabric and economic situation in Yugoslavia are fragile; 3) that Western decisions on how to respond must be made on an urgent basis; and 4) that such a response must be framed primarily to restore private bank confidence and thus to persuade banks to maintain -- and even increase -- present exposure in Yugoslavia. Also, any response must necessarily complement and support the IMF program, and might possibly attach conditions of its own. There was little sentiment for new financial assistance for Yugoslavia.

Subsequently, Secretary Regan discussed the matter with his G-5 colleagues. Some of the G-5 said that rescheduling is preferable to new assistance and that it is more or less expected by the financial world.

On December 8, Secretary Shultz met with the Foreign Ministers of France, Britain and West Germany. He emphasized of the importance of concerted Western actions to relieve those problems and keep Yugoslavia out of the Soviet orbit. The others agreed in general, but differed in their assessments of the dimension of the problem and the possibility of putting together an adequate financial package.

There will be a five nation meeting in Paris on December 17, 1982 (seven if the Austrians and Swiss attend). The main points we wish to make at that meeting are that:

- new money is preferable to debt rescheduling or a mixed package.
- we need to build a process to involve all potential donors, including non-OECD countries.
- a European country, possibly the Swiss, should take the lead. The first task of the lead country is to obtain detailed data on Yugoslavia's hard currency debt.
- we attach great importance to an IMF program which will put the Yugoslav economy on the correct path of adjustment.

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The SIG will also be asked to approve a U.S. commitment up to \$200 million in \$1.3 billion package provided: 1) there is agreement with the IMF on the program for the third year and compliance with that program; 2) that all members are satisfied with the estimates of the financial gap and that the sums they and the U.S. provide will fill that gap.

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Yugoslavia
Outline of Medium Term
(3-5 years) Financial Package
1983

	<u>\$Million</u>
IBRD Structural Adjustment	300
OECD Countries	800
France	(100)
Italy	(150)
Germany	(100)
Switzerland*	(100)
Austria*	(100)
Japan	(150)
U.K.	(100)
U.S.	(200)
Others (Mainly Middle-East)	<u>200</u>
Total	1,300

*Have informally expressed interest in participating in any package.

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Potential U.S. Participation
in Yugoslav Financing Package

	<u>\$ Million</u>
1. CCC	170
2. Exim (debt stretchout)	30
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Potential Total	200

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YugoslaviaExecutive Summary:

Yugoslavia is in a tight liquidity squeeze. Although debt service is a manageable 25 percent, Yugoslavia has little cash to meet its obligations. Foreign exchange reserves, are estimated at some \$600 million, about two weeks import coverage, and probably cannot be depleted any further. The Yugoslavs have an estimated \$800 million in gold.

Yugoslavia was on the verge of successfully completing a syndicated loan of \$200 million a few weeks ago (half the amount sought earlier) but the leading bank, Citibank, is now insisting that the Yugoslav National Bank guarantee the loan. The Yugoslavs say they do not have the legal authority to do so.

Yugoslavia has informally requested a three year, \$500 million BIS loan but these terms are longer than those usually provided by monetary authorities. Central banks have not reached a consensus on the magnitude of Yugoslavia's problem and are not assured of a take out. The request remains "under consideration". If the loan falls through, it will severely affect Yugoslavia's ability to rollover \$1.6 billion in short-term debt. In turn, this could force Yugoslavia into debt rescheduling.

Adding to Yugoslavia's problems is the fact that a 20 percent devaluation two weeks ago will increase their inflationary pressures. Inflation is already running at about 30 percent per annum, far in excess of the 15 percent envisaged by the authorities earlier this year.

In a broader context, Yugoslavia lacks the economic and financial leadership to rationalize their economy, which is segmented among the regions who maintain economic authority. This will take many years to turn around.

Looking ahead to 1983, the situation is very grave. The first half of the year is the seasonal weak half for the current account and estimates of the deficit range from \$1.2 to \$1.4 billion. There is \$1.6 billion of short-term debt falling due and \$1.0 billion amortization of loans falling due. Total financing requirements are on the order of \$3.8 to \$4.0 billion. Only \$2.6-\$2.8 billion of financing can be identified and even this amount is far from certain.

If Yugoslavia can get through the first half of 1983, the second half should see a cyclically favorable current account and under fairly reasonable assumptions, Yugoslavia may be able to meet its financing requirements. But unless it can restore its financial viability, Yugoslavia will enter the first half of 1984 in the same weak position as it is now.

Classified by M. E. Leland
Review for Declassification
on 11/15/90

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SECRETBACKGROUND PAPERYUGOSLAVIA: Economic/Financial Outlook

Yugoslavia is winding up 1982 with a current account deficit for the full year which is larger than anticipated, foreign exchange reserves equal to less than one month's imports, and strong inflationary pressures which will be exacerbated by its recent 20 percent devaluation. It has run into difficulty in wrapping up a recent \$200 million loan syndication and a request for a \$500 million three-year loan from the BIS is on hold for a number of reasons. In a broader context, Yugoslavia suffers from a lack of strong leadership to rationalize the economy and consolidate power which is segmented among the various regions.

The immediate problem is one of cash flow. Yugoslavia will soon enter the first and cyclically weak half of 1983 with the need to finance a large current account deficit, roll over short term debt, and meet existing amortization payments. The current account is expected to shift into surplus. But if the Yugoslavs are unable to increase reserves, they will face the beginning of 1984 in a similar situation to the one they face today.

Magnitude of Financing Requirement in 1983

It is not clear exactly how significant Yugoslavia's cash flow problem is for the first half of 1983 and for the year as a whole. Our best estimates indicate that the Yugoslavs will have an overall 1983 financing requirement of \$4.2 to \$4.7 billion, of which some \$3.8 to \$4 billion will have to be raised in the first half. Potentially available short and medium-term credits will total \$2.6 to \$2.8 billion, and even this amount is not assured. The financing gap could be appreciably smaller or larger depending on the strength of Yugoslavia's export performance, how much further room there is for cuts in imports, the size and volatility of worker remittances and withdrawals from private foreign exchange accounts, and Yugoslavia's ability to attract new short- and medium-term capital.

The most volatile and difficult element to estimate in assessing Yugoslavia's financial needs is short-term capital flows. Yugoslavia's year end stock of short-term credits

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stands at \$1.6 billion and matures in roughly half a year. Unless the private banks agree to roll over the majority of these credits in 1983, there is little chance that Yugoslavia can avoid requesting a debt rescheduling. In this regard, Yugoslavia's current efforts to secure this \$200 million syndication are key, for far more than the \$200 million is at stake. Should the Yugoslavs fail to reach an accord with the banks, the banking community's confidence in Yugoslavia's ability to roll over the short-term debt will be severely weakened.

The attached table projects Yugoslavia's sources and use of funds for 1983 in a manner that demonstrates its weak first semester, and relatively stronger second semester. Two points are key: (1) it assumes that the bulk of Yugoslavia's short-term debt is rolled over; and (2) it assumes a \$600 million buildup in Yugoslav reserves in the second half. Without this, Yugoslavia will face the first half of 1984 in much the same position they are in today.

The conclusion which emerges is that there is an urgent need for some timely U.S. and Allied government financial assistance -- without prejudging the amount or nature of that assistance -- to help Yugoslavia through the first half of 1983, and to put it on a stronger footing in the latter part of the year to deal with the first half of 1983.

U.S. Objectives

Any U.S. assistance effort for Yugoslavia must be geared to accomplish a number of key objectives:

-- Preserve the U.S.-Yugoslav bilateral relationship and avoid negative political fall-out from the current Yugoslav economic crisis.

-- Contribute to a long-range solution to Yugoslavia's economic problems. Stop-gap measures to see the Yugoslavs over their immediate liquidity crisis, such as a short-term governmental bail-out, will not help the GOY to appreciably strengthen their position. It would simply shift the problem to the second half of 1983.

-- Support the IMF structural adjustment programs. To put the Yugoslav economy on a sound medium-term footing, the GOY must act decisively to create a rational industrial structure, eliminate distortions in foreign exchange and capital markets, and gain more control over

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the process of wage/price determination. Yugoslavia's IMF program focuses on reforms in a number of areas designed to improve Yugoslavia's external competitiveness, reduce underlying inflationary pressures from the system of wage/price formation, and improve the efficiency of the domestic resource allocation process through basic price reforms. So far, however, Yugoslav adjustment efforts have proven inadequate. U.S. economic assistance should therefore be predicated on improved Yugoslav action in these areas, and in particular, on reform of the domestic banking system, foreign exchange markets, and credit policies.

-- Ensure equal burden-sharing both among the U.S. and its NATO Allies and between governments and private bank creditors. The U.S. share of a joint assistance package for Yugoslavia would be based most appropriately on the U.S. share in total Yugoslav external indebtedness, i.e., roughly up to 20 percent. Every dollar of U.S. assistance would thereby be leveraged five times with the West Europeans and Japanese contributing the balance. However, it is by no means clear how receptive our Allies will be to such an assistance effort, and consultations would be necessary before any U.S. financial commitment could be made.

More problematic is the comparable undertaking that we would expect from the private banks, whose exposure in Yugoslavia dwarfs that of the governments by a factor of more than 5 to 1. We must avoid a situation where governments bail out the private banks. For the short run, private bank willingness to maintain existing short-term credit lines is thus a sine qua non for going forward with a governmental assistance package. This, together with a sound stabilization program, could pave the way for a lagged private sector response to help Yugoslavia through the first half of 1984.

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YUGOSLAVIA: FINANCING REQUIREMENTS AND BORROWING SOURCES 1981-1983
(Millions U.S. \$)

	1981 Full Year	1982 Full Year	1983 Full Year	1983 First Half	1983 Second Half
I. Financing Requirement (line 1 + 2 + 3)	6452	5172 ^a	5434 to 4934 ^a	4015 to 3865 ^a	2840 to 2690 ^a
1. Current Account Balance	-1821	- 850	- 775 to - 275	-1375 to -1225	600 to 950
a. Trade Balance	-4880	-3213	-3200 to -2900	-2000 to -1950	-1200 to - 950
b. Services and Transfers	3059	2363	2425 to 2625	625 to 725	1800 to 1900
2. Repayments of Medium & Long Term Loans	-1695	-2000	-2438 ^b	-1019 ^b	-1419 ^b
3. Repayments of Short Term Loans	-2936	-2322	-1621	-1621	-1421 to -1621
4. Desired Increase in Reserves (=equals increase)			- 600	---	- 600
II. Borrowing Sources	6452	4304	4006 to 4406	2761 to 2961	2666 to 3066
5. Medium & Long Term Credits	1715	1400	1610	730	880
a. Financial Credits	1113	828	1200 ^c	500 ^c	700 ^c
b. IMF/IBRD Net	602	572	410	230	180
6. Supplier Credits	1400	1283	1175	610	565
7. Short Term Credits	3103	1621	1221 to 1621	1421 to 1621	1221 to 1621
III. Other					
8. Errors and Omissions	588	- 242			
9. Changes in Reserves (=equals increase)	- 120	1110			
EMO: Reserves at End of Period	1514	514	1114	514	1114
IV. Financing Gap. (I minus II). ()=surplus	---		1428 to 528	1254 to 904	(376) to 174

NOTE: a) Sum of financing requirements for half years exceeds financing requirements for full year as a whole because all short term loans fall due every 6 months, while full year total shows change from year-end to year-end.
b) Excludes IMF/IBRD amortization; includes Yugoslavia loans of \$250 million.
c) Assumes financial credits equal to 50 percent of repayments of medium and long term loans.

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**Yugoslavia: External Debt Disbursed
and Outstanding, 1976-81 1/**

(In millions of U.S. dollars)

	End of Period Totals						Official Projects 1982
	1976	1977	1978	1979	1980	1981	
Repayable in convertible currencies	6,627	8,154	10,233	13,224	16,848	17,820	17,108
Medium- and long-term <u>2/</u>	6,377	7,804	9,801	12,356	14,798	15,561	15,449
Short-term <u>3/</u>	250	350	432	868	2,050	2,259	1,659
Repayable in bilateral currencies	<u>934</u>	<u>1,127</u>	<u>1,362</u>	<u>1,490</u>	<u>1,542</u>	<u>1,531</u>	<u>1,481</u>
Total	<u>7,561</u>	<u>9,281</u>	<u>11,595</u>	<u>14,714</u>	<u>18,390</u>	<u>19,351</u>	<u>18,589</u>
Memorandum item:							
Ratio of medium- and long-term convertible debt to GSP (excluding Fund purchases)	19.6	19.4	20.3	20.1	23.4	25.0 <u>4/</u>	...

Sources: Data supplied by the Yugoslav authorities; and staff estimates.

- 1/ Values converted at statistical exchange rate.
2/ Original maturity over one year (excludes Fund purchases).
3/ Original maturity up to and including one year.
4/ Converted at period average rate.

Table 16. Yugoslavia: External Debt Service Payments
on Medium- and Long-Term Debt, 1977-85 ^{1/}

(In millions of U.S. dollars)

	1977	1978	1979	1980	1981	Rev. 1982	Projections		
							1983	1984	1985
A. Repayable in convertible currencies, excluding IMF debt service									
Amortization	1,492	1,774	2,287	2,899	3,582	4,371	4,610	4,320	4,100
Interest	(1,114)	(1,336)	(1,368)	(1,844)	(1,695)	(2,162)	(2,350)	(2,310)	(2,200)
	(378)	(438)	(719)	(1,055)	(1,887)	(2,209)	(2,260)	(2,050)	(1,900)
B. Repayable in bilateral currencies									
Debt service	163	121	171	207	258	273	310	350	430
Amortization	(149)	(104)	(134)	(162)	(218)	(201)	(230)	(260)	(350)
Interest	(14)	(17)	(37)	(45)	(40)	(72)	(80)	(90)	(100)
C. On debt to IMF ^{2/}									
Debt service	148	134	80	101	148	163	310	400	397
Repurchases	(124)	(94)	(59)	(70)	(88)	(55)	(196)	(312)	(327)
Charges	(24)	(20)	(21)	(31)	(60)	(118)	(114)	(96)	(70)
D. Debt service									
Convertible (A + C)	1,640	1,888	2,367	3,000	3,730	4,534	4,920	4,768	4,497
Total (A + B + C)	1,803	2,009	2,538	3,207	3,988	4,807	5,230	5,118	4,942
E. Debt service ratios ^{3/}									
(in per cent)									
Convertible currencies, excluding IMF	17.2	17.8	19.3	19.9	23.1	25.6	24.5	21.1	18.8
Total, excluding IMF	15.6	15.5	17.2	17.0	19.2	21.5	20.7	18.8	15.8

Sources: Data supplied by the Yugoslav authorities; and staff estimates. Projections do not take account of debt service on future borrowing.

^{1/} Debts with original maturity of over one year.

^{2/} Projections for 1982 and beyond based on purchases outstanding at end-November 1981. Actual charges for 1982 and beyond will therefore be substantially higher if purchases are made as scheduled.

^{3/} Ratio of debt service to exports of goods and services. Assumes exports of goods and services to the convertible area increase at 15 per cent per annum for 1983-85.

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Banks' Position Vis-A-Vis Yugoslavia
\$ millions

	Change						Position		
	1980		1981		1982		June 30, 1982		
	IIIQ	IVQ	IQ	IIQ	IIIQ	IVQ	IQ	IIQ	IIIQ
All BIS-Area Banks									
Claims	420	718	155	-202	58	37	-319	-126	NA
Liabilities	500	379	-242	-252	529	-177	-545	-19	NA
Net	-80	339	397	50	-471	214	226	-107	NA
U.S. Banks									
Claims	4	231	66	66	38	-17	-105	-131	-54
Liabilities	9	429	-381	-26	143	-14	-285	127	-109
Net	-5	-198	447	92	-105	-3	180	-258	55
Non-U.S. Banks									
Claims	416	487	89	-268	20	54	-214	5	NA
Liabilities	491	-50	139	-226	386	-163	-260	-146	NA
Net	-75	537	-50	-42	-366	217	46	151	NA

Source

BIS Quarterly Series (Differs in coverage from semi-annual series. Claims of Banks are probably \$1 billion larger than indicated in quarterly series.)
 U.S. Treasury (TIC) and Federal Reserve 2502S (Differs in coverage from Country Exposure Lending Survey which indicates claims that are larger by about \$0.4 billion.)

N.B. --Changes incorporate valuation effect of exchange rate changes, which can be substantial. These affect mainly non-U.S. banks, which have significant transactions in non-dollar currencies.

--Claims include those guaranteed by official agencies of lending countries.

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Yugoslav Indebtedness To USG
(as of 3-31-82)

<u>Direct Credits</u>	(million dollars)
Ex-Im	575.9
Foreign Assistance (and related acts)	29.8
Agricultural Trade Development and Assistance Act	
Loans of foreign currencies	37.3
Long-Term dollar credits	<u>13.2</u>
Total	656.2

NOTE: The Yugoslav's received a \$60 million in CCC financing in November 1982 of this amount \$48 million consisted of guarantees of loans and \$20 million in a direct, interest free, loan from CCC.

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Estimated Debt held by Yugoslavia at yearend 1981
(Million US \$)

	<u>Total</u>	<u>Official*</u>	<u>Private</u>
<u>Western Creditor Countries</u>	20,490	5,670	14,820
<u>By Country:</u>			
U.S.	3,246	656	2,590
U.K.	1,850	446	1,404
West Germany	1,825	325	1,550
France	NA	600	NA
Japan	NA	125	NA
Italy	165	135	30
Canada	NA	100	NA
Austria	NA	300	NA
Switzerland	NA	240	NA
Netherlands	NA	150	NA

*Official debt for Yugoslavia includes borrowings from the IMF and World Bank which totaled \$2.67 billion at end-1981.

NOTE: This country breakdown of Yugoslavia's debt is not accurate, with the exception, of the U.S., IMF, IBRD, but it is the only one we have. The U.S. share of Yugoslav debt, excluding debt to IMF and IBRD, is 18 percent.

Yugoslavia's Hard Currency
Imports and Exports 1981
in \$m by Major Market

<u>Total Hard Currency Exports</u>			<u>Total Hard Currency Imports</u>		
of which to		100%	of which from		100%
United States	387	6.8	United States	960	9.1
United Kingdom	102	1.8	United Kingdom	453	4.3
Canada	25	0.4	Canada	72	0.7
West Germany	867	15.2	West Germany	2,443	23.7
France	254	4.5	France	729	6.9
Italy	1,012	17.7	Italy	1,292	12.2
Austria	234	4.1	Austria	562	5.3
Japan	25	0.4	Japan	171	1.6
Belgium	53	0.9	Belgium	166	1.6
Netherlands	159	2.8	Netherlands	334	3.2
Switzerland	109	1.9	Switzerland	368	3.5
Subtotal	3,227	56.5	Subtotal	7,550	71.4

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IMF/Yugoslavia

- In January 1981, the GOY entered into a 3-year extended fund facility arrangement with the IMF in an amount equivalent to \$1,815 million (at end June 1982 SDR/Dollar rate) which is equal to 400 percent of Yugoslavia's Fund quota.
- The 1981 arrangement, operating within the context of the 1981-1985 development program, aimed at reducing the cumulative current account deficit from 3.5 percent of GSP in 1980 to about one percent by the end of the program period. The 1981 current account target was to reduce the deficit to \$1.8 billion, about 2.5 percent of GSP.
- Developments in 1981 were mixed. The current account deficit declined from \$2.2 billion in 1980 to \$1.3 billion in 1981. However, despite reductions in real domestic demand and fixed investment as well as GOY adherence to monetary and credit targets, retail prices increased by 39 percent rather than the planned 20-25 percent.
- The annual plan for 1982, which was incorporated into Yugoslavia's IMF standby agreement, projected a reduction in the current account deficit to \$0.5 billion and in the rate of inflation to 15 percent.
- The GOY recognized they could not meet the inflation target in 1982 and subsequently adjusted the goal to 25 percent.
- IMF staff have suggested that Yugoslavia's inability to contain the rate of inflation is due to underestimating (and therefore making insufficient allowance for) inter-enterprise credit and the use of domestic holdings of foreign exchange to finance domestic transactions. This, in turn, has led to a change in income velocity of money (GSP relative to M1) far in excess of that which was set forth in the January 1982 program, 6 percent rather than 2 percent.
- Despite Yugoslav adjustment of interest rates for the first time (from about 6 percent to about 12 percent) in February 1982 real interest rates continue to remain substantially negative. Further significant adjustments are needed.
- IMF staff have also questioned, whether Yugoslavia can meet its goal of reducing the hard currency current account deficit to \$500 million because of slower than planned growth in exports during the first half of 1982 (8 percent rather than 12 percent) and lower than expected tourist receipts and workers remittances.

-- The GOY devalued the dinar by 20 percent in October 1982 against a basket of hard currencies.

-- In negotiating the third years' program the IMF will have to find some way of reducing the inflationary impact of the use of inter-enterprise credits and the domestic use of foreign exchange.

-- As for the rundown of private deposits, and the lower than expected workers remittances, an increase in interest rates to real positive levels will help.

Yugoslavia: Position, June 1982 to December 1983 ^{1/}
(In millions of SDRs)

	<u>Actual</u>		<u>Proposed</u>				
	<u>1982</u>		<u>1983</u>				
	June	Sept.	Dec.	March	June	Sept.	Dec.
Purchases	138.5	138.5	138.5	138.5	138.5	138.5	138.5
Stand-by arrangement	138.5	138.5	138.5	138.5	138.5	138.5	138.5
Ordinary resources	--	--	--	--	--	--	--
Borrowed resources	138.5	138.5	138.5	138.5	138.5	138.5	138.5
Repurchases							
Stand-by arrangement	--	--	--	--	1.5	15.2	27.4
CFF and oil facility	4.4	12.9	17.3	17.6	38.1	34.6	34.6
Net purchases	134.1	125.6	121.2	120.9	98.9	88.7	76.5
Fund holdings							
Total (cumulative)	1,755.8	1,884.4 ^{2/}	2,002.6	2,123.5	2,222.4	2,311.1	2,387.6
Holdings in per cent of quota	422.6	453.5 ^{2/}	482.0	511.1	534.9	556.2	574.6
Excluding CFF and oil facility	(356.1)	(389.4)	(422.7)	(456.1)	(489.0)	(518.7)	(545.4)

^{1/} Purchases and repurchases in three months to end-of-month.

^{2/} August 1982.

Yugoslavia: Fund Position

(As of August 31, 1982)

Quota:	SDR 415.5 million
Fund holdings of Yugoslav dinars:	SDR 1,884.4 million, or 453.5 per cent of quota, of which:
	CFF SDR 262.7 million, or 63.2 per cent of quota
	Oil facility SDR 3.8 million, or 0.9 per cent of quota
	SFF SDR 790.2 million, or 190.2 per cent of quota
SDR holdings:	SDR 16,843; (0 per cent of net cumulative allocation of SDR 155.2 million)
Direct distribution of profits from gold sales:	US\$32.9 million
Gold distribution:	177,144 fine ounces

CONFIDENTIALSENIOR INTERAGENCY GROUP ON INTERNATIONAL ECONOMIC POLICYMEXICO

The International Monetary Fund's Extended Fund Facility for Mexico is almost ready for consideration by the Executive Board. However, before the Managing Director can present the program to the Board he needs assurances from the major industrial countries that they will provide \$2 billion (beyond present plans) of official credits during calendar year 1983. These funds and commercial bank commitments to provide \$5 billion in net new money in 1983 would complete the IMF program. (See attached Components of a Possible 1983 "Financing Package" for Mexico). We began discussions last week with a number of countries on the official credits with the possibility of commitments as follows:

France	\$150 million
Germany	200 "
Japan	250 "
U.K.	150 "
Canada	200 "
Switzerland	50 "
	<u>\$1000 million</u>

We doubt that we would receive the total \$1 billion in commitments. The United States may need to provide up to \$1.2 billion in credits, with, perhaps, \$900 million in Commodity Credit Corporation guarantees and \$300 million in financial support from the Export Import Bank. These funds would be disbursed during calendar year 1983.

Managing Director de Larosiere has asked for assurances by December 15, so he can present a fully-defined program to the IMF Board next week. Substantial U.S. Government support for this effort is necessary to assure an orderly resolution of the current Mexican financial situation. We will ask for your agencies' approval of the proposed U.S.G. (CCC and Export Import Bank) contribution at our next meeting on Wednesday, December 15.

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December 14, 1982

Components of a Possible 1983 "Financing Package" for Mexico
(Billions)

1. IMF standby	\$1.3
2. CCC guarantees (remainder of \$1 billion line)	0.7
3. MDBs and bilateral loan disbursements	0.7
4. Normal export credit receipts	0.3
5. New loans from commercial banks	5.0
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Subtotal (1-5)	8.0
6. Additional CCC guarantees and export credits	1.0 - 1.2
7. Additional official export credits: Others	0.8 - 1.0
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Subtotal (6-7)	2.0
Grand Total (1-7)	10.0

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The Situation in Poland

Polish authorities introduced a bill in the Polish parliament on December 13 to suspend most provisions of martial law. The bill has been referred to committee and the parliament is currently expected to vote on it on December 23. Its provisions will take effect on December 31. The bill, as presented, leaves some elements of martial law untouched and permits the reimposition of others on a country-wide or local basis at the discretion of the Government. The bill itself does not deal with the question of internees or those convicted of martial law violations.

Warsaw officials claim that most, and possibly all, of the approximately 200 remaining detainees will be released before Christmas. It is not yet clear what will happen to the several thousand persons who have been imprisoned for martial law violations. In his December 12 speech, Jaruzelski said that consideration may be given to clemency for these prisoners on an individual basis.

The Government claims that a dialogue has been continuously underway with the Church, but is clearly not yet ready to deal with anything resembling free trade unions. Even the new government-sponsored unions will not be in existence until next year and Solidarity no longer legally exists.

So far we have seen the release of Walesa and all but 200 other internees. There remains a considerable amount of ambiguity about further steps. Not until after January 1 will we be able to determine whether all detainees have actually been released and whether there is an active program of amnesty for some or all of those arrested for martial law violations.

If most of the more onerous aspects of martial law are actually lifted at year's end, and detainees and a significant number of political prisoners are released, it will mark an important, albeit limited, step forward. In the meantime, the Department of State and other interested agencies will be considering what options are available to the USG for dealing with the evolving Polish situation -- to encourage further movement while preserving important leverage.

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COMMERCIAL AIRCRAFT SALES TO ETHIOPIA

ISSUE FOR DECISION

Whether or not to allow the export of Boeing commercial 767 aircraft or U.S.-made components on board the Airbus A-310 to Ethiopia. Export could not be denied under existing export control regulations, unless there was evidence of an intended diversion to a COCOM proscribed destination. There has been no formal proposal to establish a new control on either security or foreign policy grounds, but Defense has expressed concerns informally.

ESSENTIAL FACTORS

Boeing Aircraft is competing with Airbus for the sale of two widebody aircraft to Ethiopian Airlines. Boeing believes (with some justification) that this sale is crucial to its chances of keeping a large share of the African market. The airline made a preliminary decision in favor of the Boeing 767 on December 12.

EAL favors the Boeing 767 (it has used Boeing equipment exclusively for over 20 years) but fears that for political reasons the U.S. will obstruct the sale of the 767's to Ethiopia. Airbus is expected to continue contesting the sale.

Interested agencies of the USG have thus far not been able to agree as to the advisability of the sale of U.S. aircraft or components to Ethiopia. The USG has therefore been unable to provide EAL with assurances that we will not block the sale. Our Charge in Addis Ababa fears that the continuing uncertainty surrounding the Boeing sale will force EAL to choose Airbus, the safer alternative.

The State Department has already informed EXIM Bank that it has no objection to EXIM's involvement (EXIM has been involved in three sales to Ethiopian Airlines in the last three years).

The Department of Defense has expressed concerns over the possible national security implications of the sale of aircraft with advanced U.S. technology to Ethiopia.

U.S. policy in the Horn of Africa calls for the exertion of pressure on Ethiopia to cease attempting the destabilization of its neighbors. We have been discussing with our principal European allies the possibility of using the prospect of cuts in assistance to induce the Ethiopians to cease their unacceptable actions. (Our own development assistance to Ethiopia was cut off several years ago because of Ethiopian failure to pay compensation to U.S. owners of nationalized properties.) The SIG must decide if the denial of a commercial sale is an effective and appropriate instrument of policy in this instance.

BACKGROUND

An interagency meeting on December 6 discussed the issues related to the sale of Boeing 767 and Airbus A-310 aircraft to Ethiopia. The issues identified and discussed included foreign policy concerns raised by the sale and by EXIM financing, national security concerns related to U.S. equipment on board both types of aircraft, and trade policy. There was general (but not total) agreement that the political issues raised by the proposed sales do not merit blocking either the export of the Boeing aircraft or the Airbus components on foreign policy grounds (which would require imposition of a new foreign policy export control, with prior Congressional notification). Five days later, State informed EXIM and the NSC that it did not oppose EXIM involvement in the sale. EXIM involvement is no longer a factor in this issue.

Concern was also expressed for the economic significance of the sale for the U.S. aircraft industry, and for the principle that commercial sales should not be obstructed save for reasons of pressing national interest. The negative consequences for U.S.-European relations of a U.S. denial of reexport authorization for U.S.-made Airbus components, and the corollary possibility of the development of Airbus models with no U.S. components, were also discussed.

Both the export of Boeing aircraft and the reexport of US components on board the Airbus require an export authorization from the USG on national security grounds in order to limit diversion to Eastern countries. Determination of the potential for diversion of particular exports depends upon an analysis of the possibility of removal or of reverse engineering of the sensitive items involved. In the case of the Boeing, items of concern are the ring laser gyroscopes, the onboard computer, and the engines.

In 1979 Boeing and Honeywell asked the Office of Munitions Control, the Air Force and the Navy to review with them the most sensitive technology (the gyroscopes) involved in the 767 (the same gyros are on the Airbus A-310 as well) to obtain an opinion on the exportability of the aircraft with those gyros on board. The services concluded that they could not be reverse engineered, and the Office of Munitions control sent Boeing a letter saying that it did not object in principle to the export of the aircraft with those devices.

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The high-bypass engines and onboard computer/avionics system are also particularly sophisticated; the SIGIEP will have to determine whether there is a risk of diversion as a result of export of these items to Ethiopia. Similar engines appear on all wide-body aircraft manufactured in the West, and would be used on any Airbus purchased by Ethiopian Airlines.